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SUBJECT: Economic Problems Growing, but Reform Only by Force

¶1. (U) Summary: On April 7, DCM hosted a discussion among a number of leading Belarusian economists. All agreed that the GOB is facing Russian pressures to sell Beltransgaz, but disagreed whether Lukashenko would allow this sale. While admitting that the Belarusian economy has had a number of successes, all explained that much of the economy is increasingly uncompetitive, lacks sufficient investment, and is overly centralized -- not just too much government control but also too many monopolies and too few export goods and partners. These experts stated that the Belarusian economy needs to reform, but they stressed Lukashenko would not willingly liberalize. The economists were split on whether Lukashenko would be forced into reform. End summary.

¶2. (U) On April 7, the DCM hosted a discussion with leading Belarusian economists. Participating were former director of the National Bank of Belarus Stanislav Bogdankevich, Ministry of Economy analyst Aleksandr Matjas, dean of the business school at the Belarusian State Economic University Sergey Krychevsky, head of the Strategy think tank Leonid Zaiko, head of the Mises Center Jaroslav Romanchuk, World Bank local representative Vadim Voronin, International Finance Corporation local head Ivan Ivanov, and International Monetary Fund local advisor Julia Lyskova. Visiting representatives from the European Bank of Reconstruction and Development's London office also took part.

Effects of a Gas Price Increase; the Battle for Beltransgaz

¶3. (SBU) Strategy think tank head Leonid Zaiko opened the debate by stating that Russia recently threatened to raise the price Belarus pays for natural gas because Moscow wants Minsk to adopt the Russian ruble as its currency and to privatize the GOB-owned pipeline network Beltransgaz. He predicted that the final gas price for 2007 would be anywhere from USD 70 to USD 135 per thousand cubic meters (tcm), depending on the GOB's willingness to make concessions. Zaiko argued that Lukashenko would attempt to stall on any price increases, since higher gas prices would end Belarus' economic growth. He guessed that Lukashenko's government might start liberalizing the economy as a result of higher prices, but stressed this is not a certainty. Former central banker Stanislav Bogdankevich believed that higher gas prices would force some liberalization, but that the GOB would have to give up Beltransgaz if it wants acceptable gas pricing. On the other hand, Romanchuk opined that Minsk would not privatize Beltransgaz, and would face greater pressure in 2006 to start market liberalization.

¶4. (SBU) BSEU dean Sergey Krychevsky claimed the GOB could absorb

some price increases, as the GOB already charges most Belarusian consumers nearly twice as much for gas as the GOB pays for it from Gazprom. Moderately higher prices would not necessarily have to be passed to most consumers, but would make it impossible for the GOB to continue to subsidize a number of firms, would make it harder for the GOB to stabilize prices, and would force the GOB to end many of the social programs that buttress Lukashenko's popularity.

15. (SBU) Vadim Voronin of the World Bank argued that Putin supported Lukashenko by not raising gas prices before Belarus' March 19 presidential election. Now Russia is starting to apply pressure to gain control of the pipelines. However, Voronin believed that since Belarus surrendered its nuclear weapons, Lukashenko wants to keep control of Beltransgaz so that he can turn off gas to Europe if he feels the need. He stressed that Lukashenko does not want to lose this means of control, but Russia will likely increase pressure on Lukashenko to surrender the company. An April 6 debate about Belarus on NTV between Vladimir Zhirinovskiy and Boris Nemtsov was one of the first steps by the Kremlin to tarnish Lukashenko's image in Russia. Voronin also explained that, according to World Bank estimates, USD 90/tcm is the break-even point for the Belarusian economy; any price above that would cause massive losses.

Successes, but Problems Worsening

16. (SBU) All conceded that there have been some successes in the Belarusian economy, namely a stable exchange rate, GDP growth, low unemployment, decreasing levels of poverty, dropping inflation, growing monetary reserves, and growing exports. However, a number of problems remain. Bogdankevich stated that two-thirds of Belarusian firms are either unprofitable or have low levels of profitability. Voronin mentioned that 33% to 37% of the economy is "ineffective." Krychevsky explained that the Belarusian economy is far too centralized, in several meanings of the term. There is little diversification of exports, with just 20 firms responsible for more than 50% of exports. An exorbitantly high share of exports to the West consist of refined crude oil, originating in Russia. Belarus has far too many monopolies, most of which do not efficiently operate. Belarus' economy also relies far too much on Russia. He likened Belarus' level of economic dependence on Russia to Canada's with the United States. As Russia reforms its economy, Belarusian firms find it harder to compete. For instance, Krychevsky stated that Belarusian exports of light industrial goods and processed foods to Russia fell 20% to 40% in 2005 alone.

17. (SBU) Voronin stated that the Belarusian economy is experiencing declining competitiveness, which he said even Lukashenko has publicly acknowledged. As a result, the GOB is phasing out some assistance to loss-making enterprises. The GOB also realizes it has a negative image for investment, so some officials are starting to talk about the need to do away with the Golden Share mechanism.

18. (SBU) Aleksandr Matjas, of the Ministry of Economy, announced that 70% to 75% of Belarusian firms use outdated technology, but they cannot upgrade because of the lack of investment. Bogdankevich added that the GOB uses ruble-denominated bank deposits as a source of cash to support unprofitable enterprises. This misdirected "investment" is likely to impact interest rates and thus deposits, creating what he termed, "a very shaky situation."

19. (SBU) These experts predict Belarus' economic woes will worsen, regardless of Russian actions. Romanchuk claimed that GDP growth is actually lower than the official 9%. He stated the GOB only measures the amount of goods produced, without taking into account the massive amount of goods sitting unsold in warehouses. He added that as the Belarusian population ages, pension reform will become a necessity. Bogdankevich explained that although inflation is officially around 8%, there is much hidden inflation that makes the true rate closer to 16%. One culprit is that the GOB is raising salaries at a much higher rate than productivity is growing. Such a trend, he concluded, is unsustainable.

Will Lukashenko Liberalize? Not Willingly

¶10. (SBU) All agreed that Lukashenko would not institute any liberal reforms by choice, but most thought economic problems would force him to initiate some limited liberalization. Bogdankevich was the most optimistic, stating that Russia could force some reform. Voronin argued that Belarus would soon need to massively restructure its economy. The GOB must increase the number of small and medium enterprises (SME) to create real jobs, and should gradually phase out subsidies such as on home utilities, phone service, and bread. Krychevsky disagreed, claiming that for reasons of political support Lukashenko would not be able to greatly decrease such subsidies, but he admitted that reform is ultimately needed. The Ministry of Economy's Matjas echoed this call for increasing the number of SMEs, and stated the GOB must change a number of laws to allow people to create their own businesses.

¶11. (SBU) Ivan Ivanov of the IFC admitted that economic life is getting more difficult daily as a result of the constant barrage of presidential decrees, but unequivocally stated that the regime will hold off on economic liberalization until the economy experiences a major crisis. Ivanov added that none of his GOB contacts have even been able to tell him what percentage of the economy is private. Without such basic information, he thought it extremely unlikely that the GOB could reform. Bogdankevich disagreed with this statement and stressed that Lukashenko would need to make some reforms. However, he cautioned that the reforms would not be major, and that for political reasons Lukashenko could not be seen as the one initiating any reform.

¶12. (SBU) Voronin asserted that the only way Belarus would democratize is, although slow, after a period of economic liberalization. Zaiko commented that many in the GOB know they need reform, but do not know how to reform and still keep Lukashenko in power. Voronin retorted that the GOB has no economic strategy and so is making numerous mistakes now that are weakening the economy. Romanchuk thought that perhaps the GOB would attempt to create a loyal economic elite, perhaps through privatizing firms to certain loyal members of the nomenklatura. He thought the people whom Lukashenko appoints to key government positions in his third term would be a strong indicator of Lukashenko's economic intentions.

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